

VZCZCXRO3879  
RR RUEHBC RUEHDE RUEHIHL RUEHKUK  
DE RUEHGB #1576/01 1340701  
ZNY CCCCC ZZH  
R 140701Z MAY 07  
FM AMEMBASSY BAGHDAD  
TO RUEHC/SECSTATE WASHDC 1134  
INFO RUCNRAQ/IRAQ COLLECTIVE  
RUEATRS/DEPT OF TREASURY WASHDC

C O N F I D E N T I A L SECTION 01 OF 04 BAGHDAD 001576

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E.O. 12958: DECL: 05/13/2017

TAGS: ECON EFIN PREL EAID PGOV I2

SUBJECT: CORRECTED COPY: ACCELERATING BUDGET EXECUTION

REF: A. BAGHDAD 1531  
1B. BAGHDAD 1474  
1C. BAGHDAD 1408  
1D. BAGHDAD 441

Classified By: Deputy Chief of Mission Daniel V. Speckhard for reasons 1.4 (b) and (d).

(U) This cable is a corrected copy of Baghdad 1550.  
Corrected text is in paragraphs 1 and 13.

11. (C) Summary: Capital budget execution in Iraq is a problem acknowledged by all levels of the Iraqi government. The GOI recognizes that delivering goods and services is a vital aspect of economic governance, and a major element of the GoI's popular reputation. Given the importance of capital budget execution as the Iraqi contribution to the Joint Economic Transition Plan, post has focused intensively on improving GOI's performance and capacity for both Ministerial and Provincial budget execution over the past several months. Deputy Prime Minister for Economic Affairs Barham Salih is chairing the effort to accelerate capital budget execution, which averaged 22% for 2006. In this cable we describe the latest information on capital budget execution for 2007, the GOI and USG efforts to improve these rates, provincial budget execution, and clarify terminology and establish meaningful metrics to quantify progress. Overall, post expects budget execution to improve in 2007 compared to 2006, as the year-old government develops its procedures. It is not likely to be, however, a completely satisfactory process: our and the GOI's ability to assess progress will be hampered by slow and incomplete GOI reporting. The 25% goal set forth in the GOI budget law should be taken as a guideline to measure funds obligated by August, rather than expended by June. End summary.

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Overall Status Update  
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12. (C) The 2007 budget was delayed by Kurdish - Central Government negotiations, both in reaching the Council of Representatives (CoR) and during deliberations there. It passed the CoR on February 8, and was signed by presidential council the following week. Minister of Finance Bayan Jabr committed to releasing 10% of the funds 'immediately', but this step was slowed by the new requirement for spending units to maintain separate capital and operational bank accounts. (Note: This development was a recommendation from the IMF for better financial management, and resolved the past problem of shifting money from capital spending to operational spending, in violation of the Financial Management Law. End note.) While a productive step in the medium-term, this new requirement did slow the disbursement of funds to some ministries.

13. (C) As of May 3, the Central Bank confirmed that most of the ministries had opened their capital accounts and could

receive funds. The exceptions, notably, are the Ministry of Oil, the Ministry of Interior, and the Ministry of Trade. The Ministries of Interior and Trade claim to have opened their accounts but the Central Bank of Iraq has yet to confirm it has been done. Because the Ministry of Oil's \$2.4 billion capital budget represents 24% of the total capital budget, this delay is of great concern. Other ministries, such as the Ministries of Communications, Health, (Lower) Education, and Municipalities & Public Works, have better expenditure records so far this year, and they have been granted another tranche of 30% of their allocation past the initial 10%. The Ministry of Agriculture has developed a detailed spending plan, by province, for its 2007 funding.

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Focused USG and GOI Efforts  
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¶4. (C) Over the past six months, the GOI at all levels has become more constructively focused on improving budget execution. In mid-February, Deputy Prime Minister (DPM) Barham Salih, Minister of Finance (MoF) Bayan Jabr and the Minister of Planning and Development Coordination (MoPDC) Ali Baban formed a Budget Execution Task Force that meets regularly with a focus on bottlenecks. Our Coordinator for Economic Transition attends these meetings, which often include Director-General level officials; the President of the Trade Bank of Iraq, for example, attended on April 23 (ref C). Results from these meetings are then brought to the attention of the Council of Ministers (CoM) every other week. DPM Salih has found the CoM a useful venue for upbraiding leaders of underperforming ministries, such as the Minister of Oil (ref B). DPM Salih used his newly-established Budget Execution Monitoring Unit to follow up in late April by

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sending letters to spending units that had not opened capital budget accounts.

¶5. (C) Minister Jabr has also productively engaged in improving budget execution, even though the Ministry of Finance remains subject to many complaints about a lack of a professional staff, and its main building was attacked with a car bomb on March 21. With significant post encouragement and support, Minister Jabr and DPM Salih organized an Iraqi budget execution conference with government officials from throughout the country on March 7, including provincial officials (ref D). The first coordinated MoF - MOPDC implementing regulations were distributed at this conference, providing badly needed clarification to spending units. Minister Jabr also has vowed to follow up with regular conferences to check on progress, encourage officials, and answer questions. The first of these follow-on conferences was held on April 5, and Minister Jabr did hold ministers, his staff, and other officials accountable for not spending money, evidence of pressure from high levels of the GOI to execute the capital budget. Promised follow-up at the provincial level, however, has yet to materialize.

¶6. (C) Effective April 1, the GOI High Contracting Committee, which must approval all contracts above a certain amount (\$1 million for provinces, \$3 million for ministries and \$10 million for the ministries of Oil, Electricity, Defense and Trade), has agreed to automatic approval of projects if there are no objections from the committee after three weeks. This committee was established to prevent corruption, an understandable concern in the GOI, but it must balance oversight with the need for a functioning procurement system. Post argued forcefully for this welcome change in the rules, as the High Contracting Committee was itself often a bottleneck blocking the expenditure of capital budgets.

¶7. (C) While raising awareness and resolving bottlenecks are important to improving budget execution, ultimately training and capacity building in the spending units is required to have a functioning system. The Ministry of Planning and

Development Cooperation is opening an Office of Government Contracting and Procurement Assistance to act as a resource open to all government officials. A USG-funded Procurement Assistance Program will provide technical assistance to the MoPDC as required, building a 'Center of Excellence' at the ministry to aid both provinces and other ministries. USG funding for this program is coming from State Department's Ministerial Capacity Development initiative, JCC-I, and the Department of Defense's Business Stabilization Operations. Additionally, USAID's National Capacity Development project has supported 13 courses in procurement since November 2006, blending international best practices with current implementing regulations. As of March 30, 267 trainees from 11 spending units attended the courses. We have also pressed Minister Baban, as recently as May 7, to organize MoPDC 'Tiger Teams' to travel around the provinces for specific assistance to provincial budget efforts. He claims to have done so (ref A). Additionally, IRMO has funded four experts to augment the three person Budget Execution 'secretariat' in DPM Salih's office.

**¶18.** (SBU) In a parallel effort, we are encouraging the ministries and spending units to look forward to formulating their 2008 budgets, a process that is in danger of falling behind schedule as it did for the 2007 budget. Late formulation of the 2008 budget would result in a second considerably shortened year for execution; due to 2007's late start, ministries have effectively eight months in which to expend their budgets.

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#### ----- Provincial Budget Execution -----

**¶19.** (C) Provincial capital budgets represent about 24% of the \$10.1 billion capital budget. In contrast to 2006 when provinces were funded through transfer grants, the provinces are now considered spending units in the government and are subject to monitoring and supervision by the Ministry of Finance and Ministry of Planning. Since 60% of 2006 money was released by the MoF only in December, and this money has been allowed to carry-over to 2007, the provinces now are flush with funds. As a result, several provinces have not felt an urgent need to open the newly required capital accounts. Of the 15 provinces outside of the Kurdish region, five provinces have yet to open accounts. Four provinces claim to have opened accounts, but the Central Bank has not yet provided confirmation. The five provinces that the CBI confirms have opened new capital accounts - Babil, Baghdad, Karbala, Najaf and Wasit -have received 10% of their 2007 allocations from the Ministry of Finance. Baghdad Amanat (the city) has also opened its account. Nine of the

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provinces have fully developed project lists.

**¶10.** (C) Several of the Provincial Reconstruction Teams (PRTs) have been invaluable in both assisting Iraqi counterparts in budget formulation and in tracking budget execution. The National Coordination Team, now the Office of Provincial Affairs, developed a monthly survey in coordination with the Embassy Budget Execution Task Force for all of the PRT members, soliciting information on funds released, requested from MoF, and expended; development of a spending plan and project list, whether that list has been approved by the MoPC, and if so, whether contracts have been advertised for bids. Resulting information is cross-checked against data collected by the Treasury Attache's Office. The GOI-organized March 7 conference was immediately followed by a two-day, USG-sponsored conference for PRT members on budget execution. A follow-up PRT workshop on budget execution and 2008 budget formulation is planned for early June.

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#### ----- The Key - Meaningful Metrics -----

¶11. (C) Monitoring budget execution has been complicated by the three to four month delay in finalized reporting from the Ministry of Finance. The USAID-funded FMIS (Financial Management Information System) has gained traction in the ministerial spending units, but the system ) designed to focus on national-level reporting - does not specifically track internal financial management of ministries. Furthermore, the information that is broken out remains confidential until finalized and released by the Ministry of

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Finance. Subject as it is to ministries' timeliness in entering data into the system, even the Ministry of Finance itself rarely has monthly information; so the results of budget execution improvements are difficult to measure using "reported expenditures" as a guide. Current information from the Ministry of Finance indicates that the provincial expenditures, even once reported, will not include a breakdown of expenditures by province; we will have to rely even more heavily on the PRTs for provincial data until provinces improve their reporting to the central ministries. For ministerial expenditures, post suggests tracking the following indicators of progress, some of which have already been used by the GOI Budget Execution Task Force to identifying underperforming spending units:

- \*successful opening of a 2007 capital account
- \*if more capital funding (past the initial 10%) has been requested from the MoF
- \*number of projects approved by the MoPDC
- \*dollar amount of projects contracted in 2007
- \*number of contracts submitted to the High Contracting Committee (HCC)
- \*number of contracts approved by the HCC
- \*amount released to the capital account, when available
- \*amount expended by the spending unit, when available

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Terminology  
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¶12. (U) We have found in our GOI budget discussions that at times the GOI uses different meanings for familiar US budgeting concepts. To assist communication among agencies in Washington and the field when discussing budget execution metrics, we share the following guide:

\*GOI Spending Plan/Budget Allocation: Budgetary authority to a GoI unit, in accordance with the Budget Law, with sub-allocations defined by the MoF. This equates to a USG "commitment," or an internal reservation of funds for a particular purpose.

\*GOI "Release": USG apportionment or release of funds from the Ministry of Finance (OMB has this responsibility in the USG) to a spending unit based on project needs or cash flow. In Iraq, this is essentially an accounting entry where MoF authorizes the Central Bank of Iraq to engage the banking system to credit the spending agency accounts.

GOI "commitments": Equates to a USG obligation, i.e. awards a contract or other binding agreement. Straightforward in the US, it is less so in Iraq for the reasons outlined above. The source of this data could be an approved project list, against which we believe we can track GOI execution. This list is maintained at the MoPDC, with a copy likely available at the Budget Execution Management Unit at DPM Salih's office.

GOI "disbursed": USG expenditures or outlays. Cash out the door is the same in both systems.

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Creating an Incentive to Spend in the Budget Law

¶13. (SBU) The 2007 Budget Law allowed for a mid-year reallocation of capital budgets for any spending unit that had failed to expend 25% of their capital budget by the middle of the fiscal year. Both the Minister of Finance and DPM Salih consider this stipulation useful in providing a 'use or lose' incentive for spending units to expend their capital budgets. This provision allows the GOI to reprogram funds from poorly-performing ministries to those who prove more capable of utilizing funds, taking into account factors like security that may have precluded timely expenditures. Post has determined, after consultation with the GOI, that the late start on the 2007 budget and exigencies of the GOI budgeting system outlined above will make it difficult for most ministries to spend 25% of their capital budgets by mid-year. It will be more realistic to work towards a 25% capital budget obligation by August. Our and the GOI's ability to assess this measurement will be indicative rather than absolute, because it will be hampered by slow and incomplete reporting as detailed above. (Note: This stipulation was changed from 37.5% to 25% during the final vote of the budget law at the Council of Representatives. End note.)

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Conclusion: Challenges and Solutions  
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¶14. (C) In addition to the delay passing the budget, the overall government system for implementing its capital budget is not well understood throughout the country. Legacy systems from the Saddam Hussein years co-exist with CPA Order 95, creating confusion. Some entities, particularly the state-owned operating companies under the Ministry of Oil, still resist the new rules, which transformed them from largely autonomous entities into spending units under the supervision of the Ministry of Finance and the Ministry of Planning. Officials from these companies argue that the constraints force them to deviate from standard practice to such an extent as to make contracting, if not impossible, then at least extremely difficult. New laws, such as the change in the provincial allocations from grants to line item spending units, further complicate implementation. Given the different security environments throughout the country, problems with communication, money transfers, and information flows also interfere with smooth budget execution. During the March 7 conference, for instance, the representatives from Rafidain Bank explained that the last time they transferred money to Diyala Province it was stolen by insurgents. International transactions involving GOI money may still be subject to an attachment risk; as a result almost all GOI international transactions are processed through the Trade Bank of Iraq's Letter of Credit (LC) program, creating what amounts to a monopoly. There is also a problem of lack of political leadership and stability - as a result of the uncertainty in Iraq working level officials may believe it is safer not to do anything rather than to try to make a new system work.

¶15. (C) Clarification of rules and guidelines, training of officials, and addressing bottlenecks are the solutions to the slow rates of budget execution in Iraq. Improved security would also help, of course, but the overriding challenges facing GOI budget execution are common among developing countries - government operations and capacity need to be strengthened. These structural and situational elements can be greatly helped or hindered by focused attention and effort on improving the situation from the highest levels of the GOI. We have been successful at convincing the GOI leadership of the importance of this issue, and post is working closely with the GOI to provide training of officials via USAID-funded programs. Training is also being carried out by MoPDC and Iraqi centers, and the GOI has begun addressing potential bottlenecks such as the High Contracting Committee and the Trade Bank of Iraq. The signing of the International Compact with Iraq will play a key role in maintaining GOI focus because it promotes

economic reform and will help normalize Iraq's financial relationships with the rest of the world.

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